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**ACCOUNTING AND AUDITING
DEVELOPMENTS
1982**



Touche Ross & Co.

ACCOUNTING AND AUDITING DEVELOPMENTS 1982



Touche Ross & Co.

FOREWORD

This booklet summarizes most of the authoritative accounting and auditing pronouncements issued in 1982, as well as a number of other releases and Touche Ross publications that address issues of current interest. For the most part we have tried to catch each pronouncement's essence in a paragraph or two. This means, of course, that these summaries should not be considered definitive or complete.

It is possible that, in the current economic climate, expert advice on the application of the standards and rules described herein will be critical to the success of your operations. So, Touche Ross stands ready to help, to answer your questions or to suggest solutions to particular problems. Just call your Touche Ross general services partner or the Touche Ross office in your area.

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New York, New York 10019

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FINANCIAL ACCOUNTING STANDARDS BOARD

STATEMENTS OF FINANCIAL ACCOUNTING STANDARDS

SFAS 54, Financial Reporting and Changing Prices: Investment Companies, is an amendment to SFAS 33 and effectively relieves investment companies of SFAS 33's requirements for inflation-adjusted information. The FASB and its respondents noted that changing prices information in these companies' financial statements would be unnecessary and redundant. The statement is retroactively effective for all fiscal years beginning on or after December 25, 1979 (the effective date of SFAS 33).

SFAS 55, Determining Whether a Convertible Security is a Common Stock Equivalent, creates a new cash yield benchmark rate for this determination. The old rule, given in APB Opinion 15, was that a convertible security was a common stock equivalent if at time of issuance it had a cash yield of less than 66 2/3% of the then-current bank prime interest rate. SFAS 55 substitutes the average Aa corporate bond yield as the new benchmark rate. This "average" yield is to be based on yields for a short period including or immediately preceding the date of issuance.

This change in principle was partly in response to the volatility of the prime interest rate in recent years. Also, the high short-term interest rates that were available during the last few years have often exceeded available long-term rates. As a result, APB Opinion 15's benchmark rule often categorized convertible securities as common stock equivalents even though their yields were higher than or equal to those of securities without the conversion option.

SFAS 55's provisions are applicable to convertible securities issued after February 28, 1982. When this Statement was released, issuers were also given the option of applying it to convertible securities issued on or before that date during fiscal periods for which annual financial statements had not previously been issued.

SFAS 56 is titled **Designation of AICPA Guide and Statement of Position (SOP) 81-1 on Contractor Accounting and SOP 81-2 Concerning Hospital-Related Organizations as Preferable for Purposes of Applying APB Opinion 20**, and that title is an adequate summary of its provisions.

The Statement is effective for financial statements for fiscal years beginning after December 31, 1981.

SFAS 57, Related Party Disclosures, establishes disclosure standards for related party relationships and transactions. Basically, this statement just formalizes the de facto standards that have been followed in practice. The requirements are generally consistent with those of SAS 6, *Related Party Transactions*.

The Statement identifies several common types of related party transactions, such as sales; purchases; transfers of real and personal property; borrowings and lendings; and services (e.g., accounting, management, legal). In addition to those between a parent and subsidiary, related party transactions encompass transactions between an entity and its principal owners, management or members of their immediate families; between affiliates; or between an entity and its pension plan.

Except for compensation arrangement, expense allowances, and other similar items in the ordinary course of business, SFAS 57 requires disclosure of the following:

- The nature of the relationship involved.
- A description and the dollar amount of related party transactions, for each period for which an income statement is presented. If no amounts were ascribed to the transaction, a description of the transaction is still required.
- Amounts due to or from a related party for each period for which a balance sheet is presented.
- For entities under common control and for which such common control relationships affect their operations, the existence and nature of the control relationships should be disclosed, even if there are no transactions between the commonly controlled entities.

The Statement is effective for financial statement for fiscal years ending after June 15, 1982.

SFAS 58, Capitalization of Interest Cost in Financial Statements that Include Investments Accounted for by the Equity Method, amends SFAS 34 (*Capitalization of Interest Cost*) by permitting interest capitalization on some equity method investments. SFAS 34 limited such capitalization to qualifying assets of the parent company and its consolidated subsidiaries. SFAS 58 says that investments (including equity loans and advances) accounted for by the equity method are to be considered as "qualifying assets" of the investor so long as the investee is in a development phase (as defined by SFAS 7) and is using funds to acquire qualifying assets for its operations.

Note that this Statement applies only to consolidated and parent-only accounting and reporting; it doesn't affect interest capitalization in the separate financial statements of investees. In this Statement, the FASB also emphasizes that under SFAS 34 it is the *investor's investment*, not the investee's underlying assets, that creates the basis for interest capitalization. Therefore, interest capitalization by an investor cannot be justified simply on the grounds that the investee itself owns "qualifying assets," or because the investee has itself invested in a start-up project. In other words, an investee's ability to capitalize interest under SFAS 34 does not create a symmetrical ability for the investor.

This Statement is effective for investments made after June 30, 1982 except that investments contracted for but not yet made may be accounted for as specified in the next sentence. Investments existing at the effective date or date of earlier adoption of this Statement (a) may be accounted for according to the provisions of this Statement or (b) may continue to be accounted for by the method of interest capitalization previously used even though not in accordance with the provisions of this Statement. Earlier application is encouraged. This Statement may be applied retroactively for annual financial statements that have not been issued but shall not be applied retroactively for previously issued annual financial statements.

SFAS 59, Deferral of the Effective Date of Certain Accounting Requirements for Pension Plans of State and Local Governmental Units, amends SFAS 35, *Accounting and Reporting by Defined Benefit Pension Plans*, by deferring SFAS 35's effective date for state and local government plans. The new SFAS 35 effective date for such plans is (plan years beginning after) June 15, 1982.

Statement 35, which is otherwise effective for plan years beginning after December 15, 1980, applies to all defined benefit plans, irrespective of the nature of their sponsor's organization.

The deferral was occasioned by the opening dialogue to establish a separate standard-setting body for state and local governments and related entities, and by the issuance in December 1981 of Interpretation 4 by the National Council on Governmental Accounting (NCGA). Interpretation 4 carried a December 15, 1981 effective date and differed from SFAS 35 principally in its guidance on the valuation of a plan's investments.

To avoid the existence of conflicting requirements, both the FASB (in SFAS 59) and the NCGA (in a March 1982 release) agreed to defer their respective requirements for defined benefit plans sponsored by state and local governments.

SFAS 60, Accounting and Reporting by Insurance Enterprises, consists of guidance extracted from AICPA Industry Guides and Statements of Position. It applies to insurance companies other than mutual life insurance companies, assessment enterprises, and fraternal benefit societies.

SFAS 60's fundamental rule is that insurance contracts need first to be identified as either *short-duration contracts* (most property and liability insurance contracts), or *long-duration contracts* (whole life, guaranteed renewable term life, endowment, annuity, and title insurance).

From the Statement's summary:

- Premiums from short-duration contracts ordinarily are recognized as revenue over the period of the contract in proportion to the amount of insurance protection provided. Claim costs, including estimates of costs for claims relating to insured events that have occurred but have not been reported to the insurer, are recognized when insured events occur.
- Premiums from long-duration contracts are recognized as revenue when due from policyholders. The present value of estimated future policy benefits to be paid to or on behalf of policyholders, less the present value of estimated future net premiums to be collected from policyholders, are accrued when premium revenue is recognized. Those estimates are based on assumptions (such as estimates of expected investment yields, mortality, morbidity, terminations, and expenses) applicable at the time the insurance contracts are made. Claim costs are recognized when insured events occur.
- Costs that vary with and are primarily related to the acquisition of insurance contracts (acquisition costs) are capitalized and charged to expense in proportion to premium revenue recognized.
- Investments are reported as follows: common and nonredeemable preferred stocks at market, bonds and redeemable preferred stocks at amortized cost, mortgage loans at outstanding principal or amortized cost, and real estate at depreciated cost. Realized investment gains and losses are reported in the income statement below operating income and net of applicable income taxes. Unrealized investment gains and losses, net of applicable income taxes, are included in stockholders' (policyholders') equity.

The Statement is effective for fiscal years beginning after December 15, 1982, with earlier application encouraged.

Retroactive restatement of all fiscal years is required unless impracticable, in which case financial statements should be restated for as many years as practicable. The cumulative effect of SFAS 60 shall be included in determining the net income of the earliest year presented.

SFAS 61, Accounting for Title Plant, is an extraction of the guidance in SOP 80-1, *Accounting for Title Insurance Companies*. SFAS 61 applies to enterprises that use a title plant in their operations (e.g., title insurance companies, title abstract enterprises, title agents). Costs directly incurred to construct a title plant are to be capitalized until the enterprise can use the title plant to do title searches. Capitalized costs are not to be depreciated. Maintenance costs and operational expenses (doing the title searches) are to be expensed as incurred. The effective date for SFAS 61 is (fiscal years beginning after) December 15, 1982. Provisions for retroactive restatement are similar to those of SFAS 60, above.

SFAS 62, Capitalization of Interest Cost in Situations Involving Certain

Tax-Exempt Borrowings and Certain Gifts and Grants, amends SFAS 34 by:

- *requiring* capitalization of interest cost on restricted tax-exempt borrowings less any interest earned on temporary investment of the proceeds of those borrowings from the date of borrowing until the specified qualifying assets acquired with those borrowings are ready for their intended use, and
- *proscribing* capitalization of interest cost on qualifying assets acquired with gifts or grants that are restricted by the donor or grantor to acquisition of those assets.

This Statement also rescinds Technical Bulletin 81-5, "Offsetting Interest Cost to be Capitalized with Interest Income." SFAS 62 is effective for tax-exempt borrowings entered into, and gifts or grants received after August 31, 1982. Retroactive application to fiscal years beginning after December 15, 1979 is permitted but not required.

SFAS 63, Financial Reporting by Broadcasters, extracts and modifies the guidance from SOP 75-5, *Accounting Practices in the Broadcasting Industry*.

From the summary:

Exhibition rights acquired under a license agreement for program material shall be accounted for as a purchase of rights by the licensee. The asset and liability for a license agreement shall be reported by the licensee, at either the present value or the gross amount of the liability, when the license period begins and certain specified conditions have been met. This Statement also establishes standards of reporting by broadcasters for barter transactions and network affiliation agreements.

The Statement is effective for financial statements for fiscal years beginning after December 15, 1982, with earlier application encouraged. Retroactive restatement is encouraged, but not required.

SFAS 64, Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements (*An Amendment of FASB Statement No. 4*) gives standards for classifying gains or losses resulting from extinguishment of debt made to satisfy sinking-fund requirements.

The first change is to paragraph 8 of SFAS 4, which states that "gains or losses from *cash* purchases of debt made to satisfy current or *future* sinking-fund requirements" do not have to be classified as an extraordinary item. The SFAS 64 amendment now exempts from classification as an extraordinary item *any* gains or losses from extinguishments of debt (cash or otherwise) made to satisfy sinking-fund requirements that must be met *within one year of the date of extinguishment*.

The second change, to footnote 2 of SFAS 4, adds the italicized condition: "Some obligations to acquire debt have the essential characteristics of

sinking-fund requirements, and resulting gains or losses are not required to be classified as extraordinary items *if the obligations must be met within one year of the date of extinguishment.*"

The Statement is effective for extinguishments occurring after September 30, 1982, with earlier application encouraged for financial statements not already issued. Retroactive application is prohibited.

SFAS 65, Accounting for Certain Mortgage Banking Activities, consists substantially of principles and practices previously published in SOPs 74-12 (*Accounting Practices in the Mortgage Banking Industry*) and 76-2 (*Accounting for Origination Costs and Loan and Commitment Fees in the Mortgage Banking Industry*). Although some respondents asked the FASB to reconsider certain provisions given in those SOPs, and to expand the guidance to cover additional types of mortgage banking transactions, the FASB has made no real changes in the original provisions.

From the Statement's summary:

Mortgage loans and mortgage-backed securities held for sale are reported at the lower of cost or market value. Origination costs associated with loan applications received directly from borrowers are expensed as period costs. The premium paid for the right to service loans in a purchase of mortgage loans ordinarily is capitalized as the cost of acquiring that right.

This Statement also establishes accounting and reporting standards for several different types of loan and commitment fees. Loan origination fees, to the extent they represent reimbursement of loan origination costs, are recognized as revenue when the loan is made. Loan commitment fees ordinarily are recognized as revenue or expense when the loans are sold to permanent investors. Fees for services performed by third parties and loan placement fees are recognized as revenue when all significant services have been performed. Land acquisition, development and construction loan fees and standby and gap commitment fees are recognized as revenue over the combined commitment and loan periods.

The Statement is effective for transactions entered into after December 31, 1982. Certain provisions on reporting the valuation and balance sheet classification of mortgage loans and mortgage-backed securities are effective for fiscal years *beginning after* December 15, 1982. Earlier application is encouraged.

SFAS 66, Accounting for Sales of Real Estate, establishes accounting standards for recognizing profit and loss on sales of real estate. It is extracted, with minor wording changes, from two AICPA Industry Accounting Guides (*Accounting for Profit Recognition on Sales of Real Estate*, *Accounting for Retail Land Sales*) and two SOPs (75-6, *Questions Concerning*

Profit Recognition on Sales of Real Estate, and 78-4, Application of the Deposit, Installment, and Cost Recovery Methods in Accounting for Sales of Real Estate). The cost accounting principles from industry accounting guides and SOPs have meanwhile been extracted for SFAS 67.

SFAS 66's summary states:

For retail land sales, this Statement requires that the seller's receivables from the land sales be collectible and that the seller have no significant remaining obligations for construction or development before profits are recognized by the full accrual method. Other sales in retail land sales projects are to be reported under either the percentage-of-completion or the installment method, for which the Statement establishes criteria based on the collectibility of the seller's receivables from the land sales and the seller's remaining obligations.

For other sales of real estate, this Statement provides for profit recognition by the full accrual and several other methods, depending on whether a sale has been consummated, the extent of the buyer's investment in the property being sold, whether the seller's receivable is subject to future subordination, and the degree of the seller's continuing involvement with the property after the sale.

The Statement is effective for transactions entered into after December 31, 1982, with early application encouraged. Disclosure requirements of the Statement are to be provided in financial statements for years ending after December 15, 1982.

SFAS 67, Accounting for Costs and Initial Rental Operations of Real Estate Projects, is extracted from AICPA Statements of Position 80-3, *Accounting for Real Estate Acquisition, Development and Construction Costs*, and 78-3, *Accounting for Costs to Sell and Rent, and Initial Rental Operations of Real Estate Projects*; and the AICPA Industry Accounting Guide, *Accounting for Retail Land Sales*, regarding costs of real estate projects. This Statement establishes whether costs associated with acquiring, developing, constructing, selling, and renting real estate projects should be capitalized. Guidance also is provided on the appropriate methods of allocating capitalized costs to individual components of the project.

This Statement also establishes that a rental project changes from nonoperating to operating when it is substantially completed and held available for occupancy, that is, upon completion of tenant improvements but no later than one year from cessation of major construction activities. At that time, costs should no longer be capitalized.

SFAS 67 is effective for real estate project costs incurred in fiscal years beginning after December 31, 1982. Earlier application is encouraged but not required.

SFAS 68, Research and Development Arrangements, responds to questions regarding contracts or arrangements under which research and development activities are funded by others. These arrangements frequently take the form of a joint venture or partnership involving the company for which the R&D is being performed. Generally there is a provision giving the sponsor an option to purchase the results of successful research. Some believe that such arrangements are simply contracts to perform R&D for unrelated parties and are to be accounted for as such. Others view these contracts as borrowings; that is, they believe the proceeds are essentially being borrowed and any R&D costs should be expensed as incurred as provided for by SFAS 2.

The Statement describes the principal issue as whether there has been a real transfer of financial risk from the R&D entity to the sponsor. To qualify as an R&D contract, that transfer must be substantive and genuine. To the extent that the R&D entity commits itself to repay any of the funds provided by the other parties *even if the project is unsuccessful*, all or part of the risk has not really been transferred.

If the R&D activity has a liability to repay the other parties, then it charges the R&D cost to expense as incurred. If financial risk has truly been transferred, the R&D activity is entitled to account for its obligation as a contract to perform research and development activities for others.

The Board's conclusions in SFAS 68 derive from FASB Concepts Statement 3, which defines liabilities as probable future sacrifices of economic benefits arising from present obligations. That Statement uses the term *obligations* to include duties imposed not only legally, but also socially. Therefore, an enterprise may have a liability that can be recognized or should be recognized for financial reporting purposes even though it is not a legal liability.

SFAS 68's provisions are effective for R&D arrangements entered into after December 31, 1982. Earlier application is encouraged in financial statements not previously issued. The Statement may be applied retroactively.

SFAS 69, Disclosures About Oil and Gas Producing Activities, (an amendment of FASB Statements 19, 25, 33 and 39) establishes a "comprehensive" set of disclosures for oil and gas producing activities. Earlier disclosure requirements are hereby superseded. Most of SFAS 69's requirements apply only to public companies; however, all companies must disclose which of the two available accounting methods is being used. (Approved forms of the so-called "full cost" and "successful efforts" methods are both permitted by the SEC and by the FASB, although the Financial Accounting Standards Board at one point tried to mandate "successful efforts" to the exclusion of "full cost" accounting.)

Publicly traded enterprises, then, must disclose the following

supplementary information if they have significant oil and gas activities:

- a. Proved oil and gas reserve quantities
- b. Capitalized costs relating to oil and gas producing activities
- c. Costs incurred in oil and gas property acquisition, exploration, and development activities
- d. Results of operations for oil and gas producing activities
- e. A standardized measure of discounted future net cash flows relating to proved oil and gas reserve quantities.

This Statement eliminates a previous requirement to disclose capitalized costs in complete sets of interim financial statements.

In addition, this Statement permits historical cost/constant dollar measures to be used for oil and gas mineral interests when presenting current cost information under the provisions of SFAS 39, *Financial Reporting and Changing Prices: Specialized Assets—Mining and Oil and Gas*.

The Statement is effective for fiscal years beginning on or after December 15, 1982, with earlier application encouraged.

SFAS 70, Financial Reporting and Changing Prices: Foreign Currency Translation (an amendment of FASB Statement No. 33), exempts enterprises whose significant operations are denominated in non-U.S. functional currencies from SFAS 33's requirements for constant-value historical cost information. Operations that use functional currencies other than the U.S. dollar should measure current cost amounts and increases and decreases therein in the functional currency, using inflation adjustments based on the U.S. CPI or the currency's own price level indexes.

SFAS 70 is effective for fiscal years ending after December 15, 1982 for which an enterprise has applied SFAS 52. Restatement of supplementary prior-year information is required if the financial statements for those periods have been restated to conform to SFAS 52.

SFAS 71, Accounting for the Effects of Certain Types of Regulation, covers regulations' effects on the financial statements of utilities and certain other regulated companies.

Generally, prices may be set at levels intended to recover the estimated costs of providing the service or product, including costs of capital. Incurred costs that will be recovered in the future should be capitalized; current receipts that are allocated to expected future costs should be recognized as liabilities.

This Statement requires recognition, as costs of assets and increases in net income, of two types of allowable costs that include amounts not usually accepted as costs in the present accounting framework for nonregulated enterprises, as follows:

- If rates are based on allowable costs that include an allowance for the cost of funds used during construction (consisting of an equity component and a debt component), the company should capitalize and increase net income by the amount used for rate-making purposes—instead of capitalizing interest in accordance with SFAS 34.
- If rates are based on allowable costs that include reasonable intercompany profits, the company should not eliminate those intercompany profits in its financial statements.

The Statement also discusses the currently accepted practices for accounting for deferred income taxes, and clarifies the application of other authoritative pronouncements with regard to public utilities. The FASB notes that expected refunds of revenue collected in prior years must be charged to income in the period in which those refunds are first recognized, and that utility leases must be classified in accordance with SFAS 13.

This Statement is effective for fiscal years beginning after December 15, 1983. Earlier application is encouraged. Accounting changes adopted to conform to the provisions of this Statement are to be applied retroactively, with some exceptions.

TECHNICAL BULLETINS

Technical Bulletin No. 82-1, Disclosure of the Sale or Purchase of Tax Benefits through Tax Leases, outlines the FASB staff's views on disclosures required when tax benefits are purchased or sold by means of tax leases. The TB does not address the accounting issue, which was to be covered by an SFAS. That planned SFAS was eventually dropped by the FASB after Congress substantially rescinded the safe-harbor leasing provisions of the 1981 Tax Act.

Basically, the disclosures should follow the provisions of APB Opinions 11, 22 and 30.

APB 11, paragraph 63 (I28.109), requires disclosure of any significant variation in the customary relationship between income tax expense and pretax accounting income (which is not otherwise obvious in the financial statements or the nature of the business) as a result of the purchase or sale of the tax benefits through the tax lease. APB 22 (A10) requires disclosure of any significant accounting policy where alternative accounting principles or practices exist.

APB 30, paragraph 26 (I22) requires disclosure of the purchase/sale transaction if it is unusual to the enterprise or occurs infrequently.

Finally, any significant contingencies associated with the transaction

must be disclosed under SFAS 5 (C59), as must any significant effects on comparability (F43).

Technical Bulletin No. 82-2, Accounting for the Conversion of Stock Options into Incentive Stock Options as a Result of the Economic Recovery Tax Act of 1981, tells how the 1981 Tax Act impacts guidance given in the following: ARB 43, Chapter 13B, "Compensation Involved in Stock Option and Stock Purchase Plans"; APB Opinion 25, *Accounting for Stock Issued to Employees*; FASB Interpretation 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*. The main areas covered are the "repricing" requirement of the Act (option price must equal or exceed the fair market value of the stock); accounting for exercise of, and cancellation of, stock appreciation rights in a tandem SAR/stock option plan; what happens if a tandem SAR is cancelled in combination with the repricing of the underlying option; and the tax treatments of compensation expense.

AICPA – AUDITING STANDARDS BOARD

STATEMENTS ON AUDITING STANDARDS

SAS 40, Supplementary Mineral Reserve Information, provides guidance to the auditor in connection with disclosure of certain supplementary quantity and price data for mineral reserves, other than oil and gas, as prescribed in SFAS 39, *Financial Reporting and Changing Prices: Specialized Assets—Mining and Oil and Gas*.

SAS 40 says that:

1. The auditor's inquiries should be directed to management's understanding of the disclosure requirements, including:
 - a. The separate disclosures of reserve-related information (estimated quantities, amounts extracted, purchased and sold, and the market price for the products);
 - b. The factors considered in determining quantities reported (e.g., reserves attributable to consolidated subsidiaries and share of reserves of proportionally consolidated investees);
 - c. The separate disclosure of interest in reserves of equity-method investees.
2. The auditor should make specific inquiries about reserve estimates, their source and the methods used to make them, make comparisons between reserve and production data and related information, and inquire about apparent discrepancies and unexpected relationships.
3. When the auditor believes the data may not be presented within the applicable guidelines of SAS 27 and he is not in a position to evaluate

responses to his additional inquiries thereon, he should report this limitation on procedures prescribed by professional standards. An example that illustrates reporting on mineral reserve information when such a limitation exists is given in paragraph 5 of the Statement.

This Statement is effective for examinations of financial statements for periods ended after March 31, 1982.

SAS 41, Working Papers, supersedes SAS 1, section 338, "Working Papers," and amends SAS 2, section 230 (par. 4), "Due Care in the Performance of Work." It was issued to make explicit, beyond any doubt, the requirement that working papers are required to support the work done and conclusions reached in a particular engagement. Otherwise, the differences from the section it supersedes are primarily editorial in nature. SAS 41 provides guidance in connection with working papers as to their (1) nature and function, (2) content and (3) ownership and custody. SAS 41 does make explicit that working papers may take the form of data stored on tapes, films or other media.

SAS 42, Reporting on Condensed Financial Statements and Selected Financial Data, provides guidance on reporting in client-prepared documents on:

1. Condensed financial statements (either annual or interim) that are derived from audited financial statements of a public entity required to file complete audited financial statements with a regulatory agency.
2. Selected financial data that are derived from audited financial statements and that are presented in a document that includes audited financial statements (or that incorporates audited financial statements by reference to regulatory filings).

(SAS 29 provides guidance when the condensed statements or selected data accompany audited statements in an auditor-submitted document.)

In the circumstances described in 1. and 2., the auditor's report should indicate:

- a. that the auditor has examined and expressed an opinion on the complete financial statements,
- b. the type of opinion expressed, and
- c. whether, in the auditor's opinion, the information in the condensed statements or selected financial data is fairly stated in all material respects in relation to the complete financial statements.

For condensed financial statements the date of the auditor's report on the complete financial statements should also be given.

Examples of the wording of such auditor's reports are presented in the Statement. The Statement also discusses the conditions when certain client-prepared documents containing condensed financial statements that make reference to the auditors must be accompanied by the auditor's report on the condensed statements and the conditions when a client-prepared document containing selected financial data may and when it may not make references to the independent auditor.

Condensed financial statements derived from audited statements may be presented on a comparative basis with interim financial information as of a subsequent date that is accompanied by the auditor's review report. The Statement presents an example of the wording to use when reporting in such a situation.

The Statement is effective for auditor's reports dated on or after September 30, 1982.

SAS 43, Omnibus Statement on Auditing Standards, consists solely of amendments to existing statements, none of which alone was considered extensive enough to merit a separate statement. The amendments are summarized below.

SAS 1, AU 150.06, Generally Accepted Auditing Standards – Clarifies the fact that the 10 generally accepted auditing standards apply to all services covered by SAS's (e.g., reporting on internal accounting control or on the application of agreed-upon procedures to specified items of a financial statement) to the extent that they are relevant.

SAS 1, AU 320.49-.55, The Auditor's Study and Evaluation of Internal Control – Clarifies that the minimum study and evaluation of the system of internal accounting control contemplated by the second standard of field work may be limited to obtaining an understanding of the control environment and the flow of transactions. Also, clarifies that the minimum documentation required may be limited to a record of the auditor's reasons for not extending this review of the system past the minimum level. Specifically, the auditor need not document his understanding of the system if he does not plan to rely on the controls.

SAS 1, AU 331.14 and .15, Receivables and Inventories – Adds, as a new potential audit procedure for significant inventories held at outside warehouses, the obtaining of an auditor's report on the warehouse's control system, such as those covered by SAS 44, *Special-Purpose Reports on Internal Accounting Control at Service Organizations*.

SAS 1, AU 420.15 and .16, Consistency of Application of Generally Accepted Accounting Principles – Removes the need in ordinary

circumstances for a report qualification regarding consistency with respect to changes between periods in the format of the statement of changes in financial position or the terms used to express changes in financial position (e.g., cash, cash and cash equivalents, or working capital) as long as adequate disclosure is made and the changes are applied retroactively to all periods presented.

SAS 1, AU 901.01-.05, .28 and .32, Public Warehouses – Controls and Auditing Procedures for Goods Held – Makes editorial changes to (1) delete certain paragraphs no longer considered relevant, (2) to describe the scope of AU 901 and (3) revise AU 901.32 (now renumbered 901.28) to make it consistent with revised AU 331.14 (see above).

SAS 2, paragraph 39 (AU 509.39), Reports on Audited Financial Statements – Changes the language in the example “subject to” report qualification due to an uncertainty (in AU 509.39) by removing any reference to the effects of the future resolution of matters on the current financial statements. (This Statement also withdraws the auditing interpretation, “Reporting on an Uncertainty,” issued in October 1979 (AU 9509.29-.32), and revises footnote 7 to SAS 15, *Reports on Comparative Financial Statements*, paragraph 5.)

SAS 5, paragraphs 5 and 6 (AU 411.05 and .06), The Meaning of “Present Fairly in Conformity With Generally Accepted Accounting Principles” in the Independent Auditor’s Report – Clarifies the order of authority of sources of established accounting principles that an auditor should consider in determining GAAP and adds to the sources certain types of pronouncements not in existence when SAS 5 was issued. (This Statement also withdraws the auditing interpretation, “Accounting Principles Recommended by Trade Associations,” issued in November 1974 (AU 9410.01-.03).)

SAS 38, paragraphs 47, 51 and 56 (AU 631.47, .51 and .56), Letters for Underwriters – Removes the expression “presents fairly” from certain of the examples of letters for underwriters to make the expression of negative assurance consistent with SAS 36, *Review of Interim Financial Information*.

SAS 39, paragraph 46 (AU 350.46), Audit Sampling – Delays for one year (from June 25, 1982 to June 25, 1983) the effective date of SAS 39.

All the amendments, with the exception of the SAS 39 postponement, are effective for periods ending after August 31, 1982.

SAS 44, Special-Purpose Reports on Internal Accounting Control at Service Organizations, provides guidance on how, under certain circumstances, one independent auditor (the user auditor) might use a special-purpose report issued by another independent auditor (the service auditor) on certain aspects of the internal accounting control of an accounting or custodial services organization. Such reports might be useful to the user auditor when examining the financial statements of a client that uses accounting or custodial services provided by the following types of organizations:

- Service centers that provide data processing functions for other organizations.
- Insurers that maintain the accounting for ceded reinsurers.
- Trust departments of banks or similar entities.
- Mortgage bankers or savings and loan associations that service loans for others.
- Shareowner accounting organizations for investment companies.

The service auditor may issue the following types of special-purpose reports, examples of which are included in SAS 44:

- Reports on the design of the system.
- Reports on both the design of the system and compliance tests that are directed to specific objectives of internal accounting control.
- Reports on the system of a segment of the service organization.

SAS 44 includes a discussion of the factors affecting the decision to obtain a service auditor's report and the circumstances when each type of special-purpose report might be appropriate. If the special-purpose report is not adequate and the user auditor plans to rely on controls at the service organization, the user auditor may perform his own compliance tests at the service organization or arrange to have the service auditor apply agreed-upon procedures to test the controls on which he intends to rely.

In using a service auditor's report, the user auditor should inquire about the service auditor's competence and consider the timing of the service auditor's report relative to the period of the financial statements which he is examining. In reporting on his examination of the client's financial statements, the user auditor should not make reference to the service auditor's report as a basis, in part, for his own opinion, because the service auditor has not examined any portion of the client's financial statements.

INTERPRETATIONS

Report Required by U.S. General Accounting Office (*An Interpretation of SAS 30, "Reporting on Internal Accounting Control"*). Although the GAO's "Yellow Book" of audit standards makes references to SAS 30's sample

report, the GAO reporting standards go beyond the scope of SAS 30. The Auditing Standards Division staff recommends modifying this sample auditor's report in the event that the audit is not sufficient for expressing an opinion on the system as a whole. The modification should include an identification of controls that were and were not evaluated. The Division includes a sample modified report in this interpretation.

Reports in Filings Other Than with Regulatory Agency on Financial Statements Prepared Using FHLBB Accounting Practices – Savings and Loan Associations (*An Interpretation of SAS 1, section 544, Lack of Conformity with Generally Accepted Accounting Principles*). This interpretation deals with recently adopted FHLBB rules permitting member S&Ls to defer gains and losses from the sale of mortgage assets. Following this rule would be a departure from GAAP. The Auditing Standards Division recommends an auditor's giving a qualified or adverse opinion when reporting on an S&L that uses this rule in financial statements other than those filed with the FHLBB. However, an S&L could avoid such an opinion if it deferred these gains and losses *only in FHLBB filings*. (Such inconsistency is permitted by the FHLBB, so long as the two sets of statements are reconciled.) The interpretation gives sample reports for situations calling for qualified opinions, adverse opinions, and opinions modified because of uncertainty.

Reports on the Financial Statements Included in Internal Revenue Form 990, "Return of Organizations Exempt from Income Tax" (*An Interpretation of SAS 14, Special Reports*). If financial statements included in such filings are not in conformity with GAAP, the auditor should consider whether the distribution of his report would make it appropriate to issue an SAS 14-style special report. Such a special report is not appropriate in the event of public distribution of the non-GAAP financial statements; in this case a qualified or adverse opinion is called for.

AICPA – ACCOUNTING AND REVIEW SERVICES COMMITTEE

STATEMENTS OF STANDARDS ON ACCOUNTING AND REVIEW SERVICES

SSARS 3, Compilation Reports on Financial Statements Included in Certain Prescribed Forms, defines a prescribed form and illustrates the form of standard compilation report that may be used when the unaudited financial statements of a nonpublic entity are included in a prescribed form that calls for departure from GAAP. The illustrative report reads:

The (identification of financial statements, including period covered and name of entity) included in the accompanying prescribed form have been compiled by me (us).

My (our) compilation was limited to presenting in the form prescribed by (name of body) information that is the representation of management (owners). I (we) have not audited or reviewed the financial statements referred to above and, accordingly, do not express an opinion or any other form of assurance on them.

These financial statements (including related disclosures) are presented in accordance with the requirements of (name of body), which differ from generally accepted accounting principles. Accordingly, these financial statements are not designed for those who are not informed about such difference.

The Statement also illustrates wording that may be used if there are other GAAP departures or departures from the requirements of the prescribed form.

SSARS 4, Communications Between Predecessor and Successor Accountants, requires the predecessor accountant to respond promptly and fully on the basis of facts known to him to appropriate inquiries from the successor. If there are unusual circumstances, and he cannot answer fully, he should indicate his response is limited.

The Statement is vague as to the predecessor's responsibilities about answering inquiries on matters dealing with the conduct of his engagement to assist the successor in facilitating his new engagement. Paragraph 8 deals with the question of access to working papers, but it too is vague, as there are no SSARS standards on the form and content of working papers for review and compilation engagements.

SSARS 5, Reporting on Compiled Financial Statements, adds to the first sentence of the standard compilation report a phrase indicating that the compilation has been performed "in accordance with standards established by the American Institute of Certified Public Accountants." The Statement is effective for compiled financial statements for periods ending on or after December 31, 1982 – earlier application is encouraged.

INTERPRETATIONS

Reporting When Management Has Elected to Omit Substantially all Disclosures. The standard report for this circumstance, given in SSARS 1, may be modified to slightly softer language than "Management has elected to omit..."

Omission of Disclosures in Financial Statements Included in Certain Prescribed Forms. An accountant's compilation report in a prescribed form may make reference to the accountant's report on reviewed financial statements that include GAAP-required disclosures. This presumes of course that there is no material difference between the compiled financial statements and the previously reviewed statements.

Reporting on Tax Returns. An accountant may accept an engagement to issue a compilation or review report on a tax return, although SSARS 1 imposes no requirement on the accountant to report on the financial information contained therein.

AICPA – ACCOUNTING STANDARDS DIVISION

STATEMENTS OF POSITION

SOP 82-1, Accounting and Financial Reporting for Personal Financial Statements, significantly changes the recommendations in the accounting portions of the 1968 *AICPA Audit Guide, Audits of Personal Financial Statements*. Whereas the Guide called for historical cost as the primary basis for personal financial statements and estimated current values as additional information, SOP 82-1 states that personal financial statements should be presented on the estimated current-value basis (although cost basis statements may be presented as a supplement). The Accounting Standards Division believes that the primary users of personal financial statements consider current-value information to be more relevant to their decision-making than historical cost information.

The SOP covers the form and method of presentation of current-value financials:

- Personal financial statements should include a statement of financial condition and, optionally, a statement of changes in net worth and comparative financial statements.
- Assets and liabilities and changes therein should be recognized on the accrual basis, presented without classification in the order of liquidity and maturity.
- Significant interests in a business and other large investments should be presented as separate line items.

The SOP also presents guidelines for estimating the current values of receivables, marketable securities, stock options, investments in life insurance and closely held businesses, real estate, payables and commitments, and income taxes.

The provisions of the SOP are effective for personal financial statements dated June 30, 1983 or later. Prior period statements should be restated for comparative purposes.

AICPA – OTHER PUBLICATIONS

AUDITING STATEMENTS OF POSITION

Auditing Property and Liability Reinsurance (October 1982) is an

auditing SOP issued by the AICPA Reinsurance Auditing and Accounting Task Force. It is to be used in conjunction with the Audit Guide, *Audits of Fire and Casualty Companies*. The SOP provides guidance to auditors of both ceding and assuming reinsurance companies in accord with the accounting principles set forth in SFAS 60, *Accounting and Reporting by Insurance Enterprises*.

The SOP briefly describes the practices of the reinsurance industry, including, in addition to primary ceding or assuming reinsurers, reinsurance pools or associations and reinsurance brokers or agents.

Ceding companies, i.e., those that contract with a reinsurer to assume part or all their original risk, should have internal control procedures needed to evaluate the financial responsibility and stability of the assuming company and provide reasonable assurance as to the accuracy and reliability of information reported to the assuming company. The SOP lists a number of control procedures that might be performed, such as analyzing recent financial information of the assuming company, reviewing other available business information about the assuming company, inquiring about its business reputation and that of its owners or management, and considering the need for and adequacy of collateral from the assuming company on certain contracts.

The auditor should review these procedures and test them if he intends to rely on them. He should also obtain reasonable assurance that reinsurance contracts are appropriately accounted for by examining selected contracts, transactions and related balances.

The assuming company should also have adequate internal control procedures to assess the accuracy and reliability of data received from the ceding company. And the company's auditors should review the procedures.

When intermediaries are involved, the auditors should obtain assurance that their ceding or assuming companies' internal control procedures provide reasonable assurance that the intermediary companies are adequately performing their functions, safeguarding their clients' funds and settling accounts on a timely basis.

The SOP, because it provides for practices that may differ from present practices, will become effective for audits of periods ending on or after December 31, 1983. Earlier application is encouraged.

Report on a Financial Feasibility Study (October 1982), a product of the AICPA's Financial Forecasts and Projections Task Force, explains that it is permissible to expand the standard accountant's report on a financial forecast which is contained in a financial feasibility study. It also contains an example of an expanded accountant's report on a financial feasibility study. The SOP is to be applied in conjunction with the 1980 AICPA *Guide for a Review of a Financial Forecast*.

The 1980 Guide provided the form of the auditor's standard report on a review of a financial forecast; it also indicated that the report could be expanded to present other information and explanatory comments. This SOP includes a detailed expanded report on a hospital's financial feasibility study to expand and renovate its facilities. Although the entity concerned is a hospital, the SOP suggests that the substance of the expanded report could be used in other situations.

The SOP provides the language that should be used in certain key paragraphs of such a report, specifically, the description of the source and responsibility for assumptions, modification for a forecast, a description of the nature of the review performed by the reporting CPA, and the absence of responsibility to update the report after its date.

The SOP is effective for accountants' reports on financial feasibility studies dated on or after November 30, 1982.

SECURITIES AND EXCHANGE COMMISSION

GENERAL

Continuing efforts by the SEC to reorganize its rules and regulations have resulted in the development of a new system for the publication of matters relating to accounting practice, disclosure and enforcement. Accounting Series Releases, which began on April 1, 1937, are no longer issued. Recognizing that the former Accounting Series Release approach covered two separate and distinct subjects, the SEC will instead issue Financial Reporting Releases (FRR) and Accounting and Auditing Enforcement Releases (AAER).

The last ASR issued was ASR 307, which rescinded interpretive guidance of two previous ASRs (see below).

ACCOUNTING SERIES RELEASES

ASR 304, the Recission of Requirements of ASR 250 for Disclosure of Nonaudit Services in Proxy Statement, is effective for statements issued after January 28, 1982. The rule that made it easier for investors to comprehend relationships between registrants and independent accountants has been rescinded. The Commission believes information pertaining to nonaudit services is important, but not a valid justification for continuation of the disclosure requirement. The information will still be available to those interested because of a recent revision of the membership provisions requiring member firms to report nonaudit service activities in annual reports.

ASR 305, Statement of Management on Internal Accounting Control, says that the SEC has decided to curtail any further action requiring

management disclosure on internal accounting control in annual reports to security holders and filings with the Commission. The staff believes the initiative of the private sector has been reliable. The increase in the number of management reports included in annual reports to shareholders greatly influenced their decision.

This is all a postscript to 1980's ASR 278, which withdrew earlier rule proposals on the subject. In the late 1970's the AICPA and the Financial Executives Institute, as well as the American Bar Association, were recommending the development of the idea of management reporting on internal control systems. The SEC says it is "encouraged" by the recent "private sector research effort" on improvements in corporate internal control.

ASR 306, Adoption of Integrated Disclosure System, is a comprehensive revision of rules, regulations, forms and schedules under both the Securities Act and the Exchange Act. This revision amounts to a "Phase II" of the Integrated Disclosure System, Phase I of which was introduced in 1980.

Among the revisions adopted in ASR 306 are:

- *Forms S-1, S-2, S-3.* A new three-tier system forms the basic framework for registration statements.
- *Regulation S-K.* Reorganized and expanded as the repository for uniform disclosure requirements of documents filed under the 1933 and 1934 Acts. Regulation S-K now contains many of the disclosure requirements from the old Guides, and revised rules for the disclosure and computation of the ratio of earnings to fixed charges.
- *Regulation C and Regulation 12B.* Revised procedural requirements for the registration of securities under the Securities Act and registration and reports under the Exchange Act.
- *Rule 415.* A new temporary Regulation C rule governing the registration of securities to be sold in delayed or continuous offerings ("shelf registrations"). The procedure eliminates normal SEC review delays and makes it easier for companies to sell securities on very short notice.
- *Rule 176.* A new rule relating to the reasonableness of an investigation to discharge obligations under Section 11 of the Securities Act.
- *Item 10(c).* New S-K item permitting the voluntary disclosure of security ratings in Securities Act registration statements.
- *Securities Act Forms.* Amended to integrate and coordinate with revised S-K and other changes. Obsolete and rarely used forms rescinded.
- *Exchange Act Forms.* Amended to integrate and coordinate with revised S-K and other changes. Obsolete and rarely used forms rescinded.

- *Rule 175.* Amended to broaden and clarify safe-harbor rules relating to projections.
- *Guides.* In Release 33-6384 (issued March 3, 1982), the SEC authorized the rescission, effective May 24, 1982, of all of the Guides for the Preparation and Filing of Registration Statements and Reports, except for those which set forth disclosure guidelines applicable to specific industries. Those which remain have been redesignated as Securities Act Industry Guides and Exchange Act Industry Guides, and are listed in Items 801 and 802 of revised Regulation S-K. These industry guides continue to remain as an expression of the policies and practices of the Division of Corporate Finance.

Those guides which relate to procedural matters have been incorporated into Regulation C and elsewhere as Rules under the Securities Act and Exchange Act, while those dealing with disclosure requirements have been conformed and incorporated into revised Regulation S-K.

Except for Rule 415 relating to shelf registrations, the new rules are effective for all documents *filed* after May 23, 1982. Thus, Forms 10-K, 10-Q, annual reports to shareholders and all registration statements filed after May 23, 1982 must conform to all the new ASR 306 requirements.

Rule 415 limits shelf registration to securities expected to be offered and sold within two years of the filing of the registration statement. Post-effective amendments must be filed if there are fundamental changes in the offering or the company (Reg. S-K, Item 512(a)), and voting equity stock offered under this registration procedure cannot exceed 10% of the aggregate market value of outstanding voting stock already held by nonaffiliates. (Rule 415 was originally effective until December 10, 1982, but its effective period has been extended. See Release 33-6423, below.)

ASR 307, Rescission of Certain Accounting Series Releases Relating to the Computation of the Ratio of Earnings to Fixed Charges, rescinds ASRs 119 and 122. These ASRs gave interpretations on that ratio, but they are no longer pertinent because the computation rules for the ratios have now been amended. Related guidance in SAB 40 (Topics 3-B and 9-B) has also been rescinded by this release.

ACCOUNTING AND AUDITING ENFORCEMENT RELEASES

AAER 1, Index of Accounting and Auditing Enforcement Releases, begins a series of Accounting and Auditing Enforcement Releases covering the SEC's enforcement activities. It includes a topical index for the one hundred former ASRs that dealt with enforcement matters.

AAER 2, Proceedings Against Louis Pokat, describes the SEC's administrative proceedings against a small CPA practice with only one SEC registrant among its clients. The SEC company is Hermetite, an over-the-counter Massachusetts concern that makes hermetic seals for the electronics industry.

Hermetite's lack of internal controls over corporate checks, signature plates, bank statements, and cancelled checks, and its failure to segregate duties were major factors that enabled the office manager to perpetuate an embezzlement for an extended period of time, the SEC says. Further, the SEC alleges that the CPA supplied EDP bookkeeping services to Hermetite (as well as other clients). The records generated by these services were in turn relied upon during the year-end audits.

As a result of its findings, the SEC barred Pokat and his firm from SEC-related practice for at least five years.

FINANCIAL REPORTING RELEASES

FRR 1, Codification of Financial Reporting Policies, announced the replacement of the ASR series and a codification of ASR material. The codification includes the text of those ASRs (or portions thereof) on accounting and auditing matters that the SEC believes are still relevant.

The SEC intends that the codification stand on its own. Therefore, there is generally no need to refer to individual ASRs when complying with SEC rules and regulations. To assist users in understanding the codification, a cross-reference index reflecting the status of each of the individual ASRs is included as an appendix to the codification. Further, the material in the codification is referenced to the ASR from which it was extracted.

FRR 2, S-X Requirements for Financial Statements of Businesses Acquired or to be Acquired and Instructions for the Presentation and Preparation of Pro Forma Financial Information, announced adoption of new rules on financial statements of businesses acquired or to be acquired, pro forma financial information, presentation of a financial forecast, and changes in other stockholders' equity. FRR 2 also revised numerous rules, schedules and forms.

FRR 3, Interpretive Release Relating to Accounting for Extinguishment of Debt, discusses so-called "quasi-defeasance" arrangements. These are transactions intended to have the same substantive effect as a legal extinguishment of debt, even though the debtor's obligations are not in fact discharged as a legal matter. The Financial Accounting Standards Board (FASB) has announced its tentative conclusion that debt should not be considered as extinguished unless the debtor has no further legal

obligation. Pending issuance of a final standard by the FASB, the SEC says that all registrants should follow the FASB's tentative decision.

FRR 4, Public Availability of Correspondence About Accountants Independence, announces a new policy regarding the public availability of letters in the SEC's files requesting the staff's views on the impact on accountants' independence of a particular set of circumstances and the staff's response thereto. Letters of request dated after November 30, 1982, and the staff's responses thereto, will be included in a public file and will be available at the Commission's Public Reference Room for public inspection and copying 30 days after the staff has given or sent the response to the person requesting it. Private or confidential information will be excluded from these files.

The Commission will continue to issue releases from time to time that summarize and discuss its views on independence questions.

FRR 5, Accountants' Liability for Reports on Unaudited Supplementary Financial Information. In Release 33-6208 (April 30, 1980) the Securities and Exchange Commission proposed amendments to Rule 436 of the Securities Act of 1933 that would have provided that reports issued by independent accountants on unaudited supplementary financial information as to the effects of changing prices and as to oil and gas reserves were not reports for purposes of Section 7 and 11 of the Securities Act. The proposed rules would have excluded such reports from liability under Section 11(a) of the Securities Act of 1933, and were intended to facilitate the development of explicit reporting on supplementary financial information.

Because projects underway in the private sector are likely to delay consideration of explicit reporting on supplementary financial information by the Auditing Standards Board of the AICPA, FRR 5 withdraws these proposed rules changes. The Commission will reconsider these proposals if, in the future, it believes such action is necessary to facilitate a private sector determination that accountants should report explicitly on supplementary financial information.

FRR 6, Interpretive Release About Disclosure Considerations Relating to Foreign Operations and Foreign Currency Translation Effects, discusses the types of information about foreign operations gained as a result of implementing SFAS 52 (*Foreign Currency Translation*) and its modifications and amendments. The SEC believes such information could, in many cases, be used to develop improved disclosures relating to foreign operations and foreign currency translation effects. Therefore, the Commission encourages voluntary experimentation with meaningful disclosures in this regard. The release also addresses disclosure considerations related to the new standard's transition provisions.

FRR 7, Adoption of Foreign Issuer Integrated Disclosure System, announces the adoption of a comprehensive revision to the rules and

forms applicable to foreign private issuers registering securities under the 1933 and 1934 Acts. This involves (1) the adoption of three registration forms that constitute the basic framework for registration statements of foreign private issuers under the Securities Act; (2) the revision of Form 20-F (the consolidated registration and annual report form for foreign private issuers under the Exchange Act); (3) the adoption of a rule relating to the age of financial statements included in filings of foreign private issuers; (4) the adoption of a rule relating to the currency in which the financial statements of foreign private issuers are to be presented in filings with the Commission; and (5) the revision of various other rules to implement these rules and to reflect other changes.

STAFF ACCOUNTING BULLETINS

SAB 43, Early Adoption of ASR 302, gives the SEC staff's views on early adoption of the new rules for parent company and other financial disclosures announced in Accounting Series Release 302, issued in November 1981. That ASR announced Regulation S-X amendments modifying requirements for providing financial information in three separate reporting areas: the parent company only; unconsolidated subsidiaries and 50 percent or less owned persons accounted for by the equity method; and consolidated subsidiaries engaged in diverse financial-type businesses. The rules are effective for fiscal years ended after March 15, 1982. Where early application is elected, full application of the new rules is required. In SAB 43 the SEC staff interpreted this "full application" to mean that a registrant may elect to early adopt the new rules in one or more of the three reporting areas.

SAB 44, Staff Views on Implementation of ASR 302, deletes certain topics published in SAB 40 and gives staff views on implementation of ASR No. 302, "Separate Financial Statements Required by Regulation S-X."

SAB Topics deleted by SAB 44:

- Topic 1-B (Parent Only Financial Statements)

- Topic 6-B (ASR 175 – Rule 3A-02(e))

- Topic 6-C (ASR 250 – Disclosure of Relationships with Independent Public Accountants)

SAB 44 contains interpretations of ASR No. 302 concerning restricted net assets, application of tests for parent company disclosures, undistributed earnings of 50% or less owned persons, and application of the significant subsidiary test to investees and unconsolidated subsidiaries.

SAB 45, Pro Forma Presentation of Former Owner-Manager's Salary in a Pooling-of-Interests, adds Topic 2(C) to the current codification. When a

planned or consummated business combination to be accounted for as a pooling-of-interests involves a closely owned and managed enterprise and the salary of an owner-manager will be substantially changed resulting from a new employment contract, the registrant may include a supplemental pro forma presentation to reflect changes in salary expense following the merger. This interpretation focuses on the owner-manager's salary in particular but the SEC staff believes that the general principles are relevant to other owner-manager expenses that become increased or reduced through contractual agreements.

SAB 46, Revisions to Interpretations of Interim Financial Reporting Requirements, makes a number of small revisions in the existing SAB codification, and deals exclusively with interim financial reporting (Topic 6(G) of SAB 40). These changes were necessitated by the adoption of Accounting Series Releases that revised disclosure requirements for interim reporting (ASR 286); eliminated requirements for the presentation of separate financial statements of the parent company only, and of consolidated subsidiaries engaged in diverse financial-type activities (ASR 302); and made revisions to the disclosure requirements of Form S-K (ASR 306).

These revisions include the elimination of certain interpretations from Topic 6(G) – 1a - Q1, 1b - Q1, 1c - Q2 and Q3, 1d - Q1, 2a - Q1, and 2b - Q1. The remaining interpretations and questions have been renumbered and revised to reflect the latest Regulation S-X and S-K requirements.

SAB 47, Oil and Gas Producing Activities, adds new Topics 2(D) and 12, deletes Topic 6(J), redesignates Topics 6(D) and 6(E) as Topics 12(A) and 12(B), respectively, and adds questions to Topics 12(A)(2), 12(A)(3)(e), 12(C), 12(D) and 12(E).

The new interpretations under Topic 2(D) include discussions on the accounting treatment for exchange offers; acquired property interest; "reorganization accounting"; recording of deferred tax credits in tax free exchanges accounted for as poolings; and oil and gas reserve data disclosures required by Regulation S-X Rule 4-10(k), (5) to (8).

Also discussed: application of the full cost ceiling limitation; pro forma information in filings; audited historical financial statements of acquired companies pursuant to Regulation S-X Rule 3-05 vs. presentation of less than full audited statements; discussion of waivers for prior year statements of offerees; reorganization accounting and full historical financial statements.

SAB 48, Valuation of Assets Acquired from Promoters and Shareholders, contains the staff's view that when a company acquires assets from promoters and shareholders in exchange for stock just prior to, or at the time of its first public offering, the assets should generally be recorded at cost to the promoter or shareholder.

Deviations from this policy have been rare, but the staff will not always require that predecessor cost be used to value nonmonetary assets received from a company's promoters or shareholders. It has not been followed where the fair value of either the stock issued or assets acquired is objectively measurable and the transferor had not retained a substantial indirect interest in the assets as a result of significant stock ownership in the company.

SAB 49, Disclosures by Bank Holding Companies About Certain Foreign Loans, deals with the current problem of large outstanding loans to countries experiencing liquidity problems. This new interpretive guidance is codified as Miscellaneous Disclosure under Topic 11(H). The guidelines offered by the SEC staff recommend disclosing the following information if a bank has one percent or more of its loans subject to such unusual risks:

- the names of the countries involved;
- the dollar amount, percentage amount, or other clear indication of the amounts at risk;
- the presumed effect that the current liquidity crisis will have upon the registrant's financial condition.

OTHER SELECTED SEC RELEASES

Release 33-6389 announces new Regulation D, establishing exemptions from the registration requirements of the Securities Act and was effective on April 15, 1982. The Regulation replaces the requirements under to-be-rescinded Rules 146, 240 and 242 which are rescinded as of June 30, 1982. The series of six rules simplifies and expands the existing exemptions and achieves federal-state exemption uniformity. New Rules 501 through 503 contain definitions and conditions that apply generally throughout the regulation, while Rules 504, 505 and 506 contain specific registration exemptions.

Release 33-6364 is one of the sole sources of interpretive guidance on the subject of disclosure of management remuneration (Regulation S-K, Item 4) in filings with the Commission. Many of the previous releases on this subject have been superseded or incorporated into later releases. After the adoption of Release 33-6261, which significantly changed requirements for disclosure of officer and director compensation in registration and proxy statements and periodic reports filed under the 1933 and 1934 Acts, the SEC was forced to provide an up-to-date version of Item 4. Release 33-6364 is presented in a question and answer format.

Release 33-6423 extends the effective date of Rule 415 until December 31, 1983. The rule relates to the registration of securities to be offered and sold on a delayed or continuous basis in the future ("shelf registration"). The requirement to file post-effective amendments reflecting the addition

or deletion of a managing underwriter has been dropped. Rule 415 was originally adopted, on a temporary basis, in ASR 306.

Release 34-18647 eases some of the 1934 Act registration and reporting rules affecting smaller businesses. The exemption ceiling has been raised to \$3 million under Section 12(g), whereas before public companies with less than \$1 million in assets were exempted from the Act's registration requirements. The current deregistration provision allowing a company with less than 300 shareholders to terminate at any time has been amended so that a company may deregister if it has less than 500 security holders on the last day of each of its most recent fiscal years.

TOUCHE ROSS ACCOUNTING AND AUDITING PUBLICATIONS

Business Combinations, Interpretations of APB Opinion Nos. 16 and 17. This is the third edition of the Firm's Business Combinations book, a comprehensive revision of the last version. It includes extracts from Opinions 16 and 17 and pertinent FASB pronouncements, and formal and informal interpretations of the SEC and the AICPA. Also included are Touche Ross comments in those situations where the Firm's accounting treatment differs or where the authoritative information needs clarification.

New in this edition are an appendix that illustrates financial statement presentation of accounting for the various aspects of business combinations and an expanded, comprehensive topical index.

The Effective Audit Committee is the Firm's guide to shaping these committees' agenda and interaction with company management. Currently most public companies' boards of directors have audit committees, and SEC activism has influenced many of them to expand their scope beyond audit committees' traditional areas (review of annual financial statements and related audit, overview of internal controls, and selecting or recommending outside auditors). New audit committee areas of involvement include review of interim reports and direct interaction with the outside auditors. This booklet offers lists of questions an audit committee might ask auditors (pre-audit) about audit scope and (post-audit) about internal control, financial statement information, and the results of the audit.

Questions Shareholders May Ask at 1982 Shareholder Meetings mentioned such obvious topics as idle plant capacity, unemployment, poor liquidity in the thrift institutions, and economic forecasts in general. Specific sorts of questions to be expected were inquiries about overseas investments—how is the company protecting itself against exchange rate

fluctuations; will foreign currencies' devaluations hurt business; will competitive imports adversely affect sales. Other suggested questions covered the company's audit committee, litigation and legal fees, and safe-harbor leasing.

Controlling Assets and Transactions in Hospitals is an industry-specific guide utilizing TRACE, the internal control evaluation system developed by the Firm and described at length in the 1979 publication, *Touche Ross Accounting Control Evaluation - Controlling Assets and Transactions*. Although prepared by Touche Ross, the *Hospitals* book is published under the aegis of the Healthcare Financial Management Association. It adds to the original TRACE format certain evaluation procedures that take into consideration the overall regulatory environment of hospitals and the particular transaction cycles specific to these entities. Hospitals are prone to particular types of control weaknesses, e.g., a tendency to incur costs without relating them appropriately to revenue, as when patients are treated without being properly registered beforehand. These potential weaknesses and related control evaluations are discussed and illustrated in this book.

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